



Syariah-Based Contract Farming as a Socio-Business Model: Experience of Local Phenomena

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The theoretical problem dealing with the concept of contract farming and syariah financing is still said to be a partial concept. It is due to the fact that contract farming is not only enhancing the income, but also creating the dependency [among the farmers]. On the other hand, syariah financing in agricultural sector is not quite popular yet due to its high risk. If both of them are synergized with local wisdom, it is expected that their weakness of both aspects might be eliminated and capable of strengthening a positive empowerment. The objective of this research is to (a) explore the implementation of contract farming and syariah financing in a local level; (b) find out the position and farmer's interest and capital owners of those two systems; (c) the benefit relationship between contract farming and syariah system for the sake of farmers and capital owner's; and (d) develop syariah contract farming as socio-business model. The research was conducted through some survey, in-depth interview, structured interview, and Focus Group Discussion with farmers, businessmen, small and medium enterprises (UKM), such as Koppontren and sugar mill/factory, and local government. The reason was due to the fact that those people and institution knew the real problem very well and how to overcome that problem in accordance with their own needs. The research result showed that contract farming had been known very well in agricultural sector, livestock and some other non-agricultural business. The reason for the development of contract farming was due to the fact that the farmers needed land and capital for their business. However, the capital owners were actually the ones who really needed the farmers for their business sustainability. Furthermore, contract farming system was capable of increasing some business productivity and income although the farmers became dependant to the capital owners. Hence, both the farmer's interests, and capital owners had already been accomodated by the system. The new syariah system had been developed in non-agricultural sector. Meanwhile, in agricultural sector, Syariah-based contract farming had not been developed well because the capital owners did not want to bear the risk(s). The development of this system in sugar cane business was due to the fact that the capital owners could organize and control the market so that it could reduce the risk burden. This was the factor to become the syariah-based contract farming system of a certain commodity (sugar cane business) could finally develop well. There was a tendency of shariah contract farming which not only for an economic purpose but also social missions. However, this had to be beneficial. This was then called as social business model.

Keywords: Contract Farming, Shariah, Social Business.

1. INTRODUCTION

The farmers' main problem is closely related to the access to resources, productive employment, and social capital. They made most farmers have weak economy and lack of confidence.

Therefore, the actualization of development concept needs to be organized on behalf of farmers and in accordance with local potential and culture (self reliance).^{1,2}

The condition of smallness is conceptualised as the circularity perceptions, attitudes and consequent practices that reflect lack

of knowledge, time and capability. It is argued that this condition of smallness inhibits growth to create a wicked problem that explains why most small firms don't grow.³

In general, to get a capital, the bank or creditor requires some security or collateral. Therefore, if the farmers do not have any collateral, they are forced to get the loan from money creditors/lenders who do not necessarily ask for collateral.^{4,5} One of the effective strategies to increase farmers' income can be done based on contract farming⁶⁻⁸ and syariah-based institution⁹⁻¹¹ approach. Such kinds of approaches are what is called as Social Business Models.¹²

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Contract farming is an institutional mechanism (contract) to strengthened farmers' bargaining position with other institution(s) with stronger economical power. Contract farming can also be considered as potential and risk sharing which objectives are to enhance farmers' efficiency and income. That is the reason why other form(s) of credit is still needed in contract farming which is based on their necessity.⁶

The emergence of shariah financing company is an alternative solution to strategic problems¹⁴ because conceptually, it is relevant with agricultural business. Its three characteristics are without any interest, implementing profit and risk-sharing principle, and the benefit (of the contract) will be accounted after the transaction period ends. Therefore, shariah system in agricultural sector needs to be researched academically. The main difference between shariah financing company and conventional bank lies on the existence of interest and economic justice.

There are two problems revolving around the implementation of contract farming. Those are *first*, different bargaining position between farmers and capital owners. Conceptually, farmers tend to have a more benefiting position though factually, they are on the weak side.¹⁵ Hence, it strengthened capital owners' position and create a dependency. *Second*, breach of contract such e.g., farmers do not pay back and there is no rate guarantee.

Some problems of syariah financing happen between farmers as the debtors and financing company as a creditor are

- (1) The farmers think that the creditors are not involved yet in bearing the risks; and
- (2) According to the syariah financing company's point of view, the problems dealing with financing and where the capital resource are obtained from is closely related to the owned capital and its source, small market share, lack of human resources, conventional bank's strong impression, yet optimal political will, lack of shariah socialization and network.

The questions are *first*, how to develop shariah-based contract farming in order to enhance farmer's profit efficiently and effectively in accordance with local potential. *Second*, how to implement shariah financing at the level of financing companies as well as farmers. *Third*, who obtains the benefit and how to empower and integrate contract farming and shariah financing so that it can turn into productive resources.

Those issues shall be examined theoretically and practically. Contract farming and shariah financing are both implemented and has its own advantages. Contract farming is widely implemented in agricultural production sector, but the business risks are fully borne by the debtor (farmers). On the other hand, although shariah financing is less widely implemented in on-farm sector, it distributes the risks between the debtor and creditor. If both concepts are combined together, it may become a scholarly capital and might be able to give a conceptual contribution in enhancing agricultural development.

The objective of this research is to

- (a) explore the implementation of contract farming and shariah financing in local area;
- (b) find out the position and significance of farmer and capital owners in the schemes;
- (c) discover contract farming and shariah financing's relationship to farmer and capital owner's interest; and
- (d) promote shariah contract farming as socio-business model.

Benefits that will be generated from this research are

- (1) discover what is needed by farmers in shariah financing system and its impact to their business activity;
- (2) debtor know where shariah financing companies obtain their source of capital; and
- (3) promoting contract farming and shariah culture in agricultural activities and industry to improve farmers and businessmen's welfare in accordance with local potential.

2. METHODOLOGY

This research was conducted with survey, in-depth interview, structured-interview, and focus group discussion to farmers, businessmen, small and medium enterprises (SME) such as Koppondren and sugar mill), and local government. They were picked because it is believed that they know better about the problems and necessary alternative solutions to the problems.

The stages of this research are:

- (a) socializing the definition, objective(s), and benefit(s) of shariah financing research to the stakeholders;
- (b) survey and observing farmers' issues and expectations through in-dept interview;
- (c) observing shariah financing company related with its historical background, the actors, and why it is chosen by farmers; and forum group discussion.

3. RESULTS AND DISCUSSION

3.1. The Role of Local Figure

Public figure (such as priest (kiai) or religious leader acts as the centre of change development because of his/her futuristic idea. S/he gives not only religious education but also the economic value of its alumni. The development scheme of boarding school that involves business unit aligns the religious leader with capital owner. Because of that relationship, there is interdependency between the boarding school business unit's holder and its business partner. However, the power is still accumulated in the religious leader.

This condition indicates that the boarding school's business unit has dual objectives, which are economic acceleration and development and accumulation of power. Hence, religious leader's power and authority as boarding school's ruler has shifted and become more dynamic.

3.2. Contract Farming and Syariah System in a Local Level

Contract system in agricultural as well as non-agricultural sector is carried out through capital sharing and distribution of work and risk. Such system emerges because lack of capital, innovation, technology, and market access. The availability of capital, innovation, and market access give a sense of security to farmers in conducting their business.

There are two types of contract systems in local area, those are *inti-plasma* system and operational cooperation system. Previously, *inti-plasma* system growing in the form of PIR or TRI. In this system, farmers provide the land, whereas the capital and market are provided by the company or factory. The consequence of implementing this system is it creates instability to the sugar factory because farmers are free to either working on it or not. The second system does not fully advantageous either.

Table I. Realization of Koppontren's credit in 2008–2013.

Year	Loans of distributed (million)	Credit bank (million)	Independent capital (million)
2008	1.200	1.1000	1000
2009	1.500	—	1.500
2010	1.400	844	556
2011	1.400	603	797
2012	1.600	678	922
2013	1.500	707	793

In operational cooperation system, there is the capital owner(s) who lend capital to farmers. The debtor (farmers) is obliged to pay the interest that makes people grieve.

The religious leader is well aware of this issue. Ever since 2007, savings and loans business that was run in “*Koperasi Pondok Pesantren*” (Koppontren) or Boarding school's cooperation which established in the late 1990s has been developed into syariah financing venture. Koppontren is committed to have social responsibility in developing local economy. In order to achieve it, Koppontren entered into agreement with Bank Muamalat in Malang. Their cooperation on credit development and distribution can be seen in the Table I.

The capital investment coming from Koppontren's deposits, Koppontren management's and pilgrims' deposits, and donations.

Farmers who took the survey were sugarcane farmers. Koppontren stated that farmers outside sugarcane farmers are not given the credit because they are considered as having more risks. Sugarcane farmers on the other hand, able to minimize their risk of failure because Koppontren dominates the market. In other words, farmers only need to harvest the sugarcane while the sale is done by Koppontren to the factory. The factory will transfer the payment to Koppontren's bank account. Finally, farmers will be able to obtain their payment through Koppontren.

According to existing data, 35% of sugarcane farmers obtain less than Rp. 5.000.000 in credit; 30% of them obtain between Rp. 5.000.000 to Rp. 10.000.000, and the rest 35% obtain more than Rp. 10.000.000. Those who are trustable even obtain up to Rp. 80.000.000 credit. Contradictory reality happened in small-medium enterprises that 40% of them obtain less than Rp. 5.000.000 with minimal amount of Rp. 1.000.000. The rest of them obtain credit fund between Rp. 5.000.000 to Rp. 10.000.000.

The conclusion is that syariah credit (financing) can be given to agricultural or non-agricultural business sector though the allocation for sugarcane farmers is bigger. On the contrary, farming (cow) does not get the loans because it has higher risks.

Based on the Table I, it could be concluded that syariah credit could be given to both the farmers and community (UKM). However, the credit portion for the sugar cane farmer is higher than the others. On the other hand, livestock business (cows),

although this business is considered to be featured, it doesn't get a credit because of the risk factor.

3.3. The Farmer's Position and Capital Owner

The farmer feels to get benefit from the syariah credit since the process is not complicated and without collateral. One institution to be the most common and trusted to get this kind of credit is a cooperation owned by an institution of Islamic learning centre (*koppontren*). A trust imagery is the most important thing to be maintained. Once someone is not trusted, one institution or some one would not get a credit any longer. This credit is much different from the other conventional credits which have more complicated procedures. Besides, the conventional credit needs collateral and charges higher interest.

Dealing with that phenomena, then syariah credit can be used as an alternative consideration to get a credit rather than the conventional credit. However, the creditor still got the benefit from this syariah system since it has more secure seen from the risk side. Although it has a little margin ratio, no penalty, no interest, it is still profitable. Although the main purpose is for social interest, the business target has also to be considered, regarding with brotherhood and morals of islamic economy to be the priority.

3.4. The Benefit of Contract Farming and Syariah System for the Farmers and Capital Owner

Contract farming, has been social's culture for a long times in the agriculture sector, livestock and other non-agriculture business. The farmer needs farmland and the stock for their businesses. Otherwise, the stock holder needs the farmer to their business' continuation. In the other side, contract farming scheme could increase the business productivity, yet it doesn't automatically increase their income, because the farmer bounds by dependency in stock holder scheme.

The syariah scheme just being evolve since 9 years ago (2007), although it just in non-agriculture sector. In both agriculture and livestock, except for sugar cane planting, the contract farming scheme syariah-based on doesn't evolve since the stock holder doesn't want to take a risk. This scheme's development in sugar cane business is because the stock holder could organize and dominate the market, so that they could decrease the risk. This factor caused the contract farming-syariah-based on in sugar cane sector could evolve.

3.5. Discussion

The basic principles of contract farming and syariah is the partnerships. The commitment used was *koppontren* which had their social responsibility in order to develop the society's economy. If the society has a strong economy, the existence of islamic boarding school (ponpes) becomes strong also. In order to reach the an expected idea, koppontren, besides includes their own stock, also cooperates with the banking.

Syariah business unit as the model of social business has two main components. They are:

- To consider who the pilgrims/learners/occupants of islamic boarding school and what their need.
- To offer the best service to the pilgrims.

This component not only includes kijaji/islamic religious leader (priest) value chain (?) and the islamic boarding school, but also the students' network, the pilgrims and their relatives/partners.

Table II. The amount of credit obtained based on the business type.

No	Type of business	Credit value (million)	Number of farmers (%)	Interval (000.000)
1	Agriculture (sugar cane)	>5	35	1–4
		5–10	30	5–10
		>10	35	13–80
2	Non-agricultural (small-medium enterprises)	<5	40	1–2
		5–10	60	5–6

It is compared to the conventional business model, the syariah business unit has the similarity since both of them cares about consumer's needs, they find their new profit's source by looking for a new combinations.

3.6. How the Koppontren Builds Their Social Business Model

The first step: they defy a few of conventional policy and the basic assumptions. The syariah contract farming which started from islamic boarding school is a radicalism innovation that competent to creates the new strategy by changing the business rules and the culture. The experience they used is the poor phenomenon who couldn't relates to conventional bank. They couldn't upgrade their business since they have no stock and collateral. They couldn't lend fund to the conventional bank because they have no credit history and there is no warranty/guarantee/collateral to offered. They couldn't fill the documents they need because of their illiterate. But their local leader trusts them, so gives them the financing without any collateral. So that their stock business could increase eventhough they have no collateral. Even so, the conventional banker still reluctant in order to examine the poor as their potential customer. This impression caused the syariah loan in 2007 which leads to the creation of koppontren business unit in the future. Therefore the syariah business model defy a few of conventional banking assumptions, including the conviction that there's no loan without collateral. *The second one,* they build a partnerships in order to increase their expertise and resources which is not the first time in the business model's literature. The open business model makes the partner companies get profit from the new sources. This partnerships covers long-term relationships among the doers (kijaji, society, pilgrims, government and banking itself). Therefore the collaborative organization generate a new resources.

As it has been pointed by the characteristic of syariah business model innovation which aims to giving a social benefits, syariah business unit's impression describes how the big step in developing social business model materialized by build a partnerships. This means that social business is a metamorphosis of business. The Al Rifaie koppontren, not only has a business concerns but also has a social goal, specifically they want to help

their pilgrims' concerns. This idea is what they called as "social business," the new type of business later.

There are two kinds of business organization in capitalist system, they are: the organization which for maximizing the profit and the non-profit organization which for satisfy a social goal. The social business follow both of these two entities. The stock holder operationally has the right to get their stock back. There are a potential and serves as a agents of change besides profit-driven impulse in social business (Fig. 1).

In organization structure, this social business basically similar to profit maximization. Even so, there is a decisive difference between business and charity. The managerial's mindset should be as same as business, that is profit maximization. The difference come up to the mindset when they aim to do the charity besides managing their business.

In social business, the operational cost must be reached self-sustainability while the social goal must be reached as well at the same time. There is no intention the stock holder in order to seek the profit for their own concerns. Even they have a right to get their stock back if they want. However the additional value they produced, would be re-invested to the business. In the end, this would be continued by the target group whose benefit recipients in form such as: a lower cost, better services and bigger access. Therefore the social business designed and operationed as a business company with their products such as: customer services, markets, costs and incomes.

However, the social business should not get loss, with no dividend because the investment had to be paid back to the capital owner. The main objective was the same, which was to serve the people who need capital. Hence social business is the new form of business which both profit maximization and non-profit organization.

4. CONCLUSION AND SUGGESTIONS

Contract farming has become local culture both in agriculture sector and non-agriculture. The evolve of contract farming caused by the society who needs a stock and farmland for their business, otherwise the stock holder needs them in order their business continuance. The contract farming could upgrade its

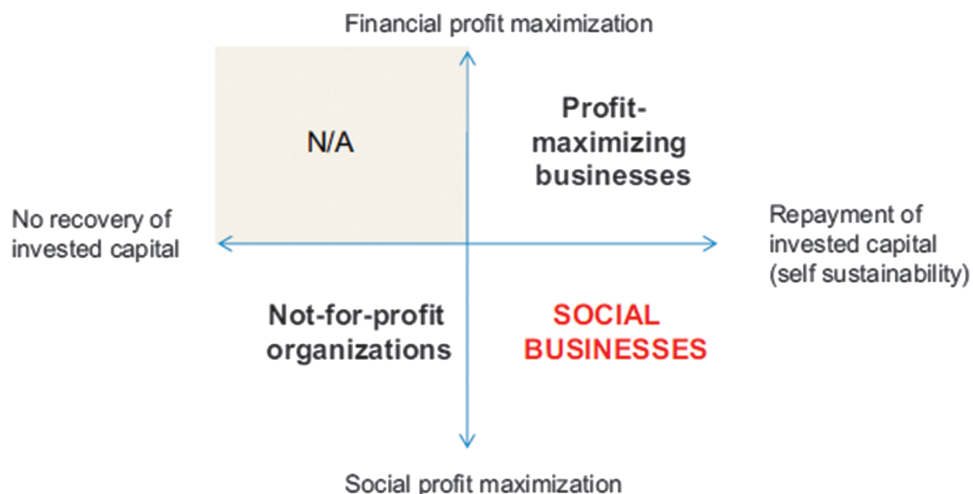


Fig. 1. Social business versus profit maximizing business versus non-profit organizations.

business productivity, but not automatically increase its income since the farmer bounds by the stock holder dependency scheme, yet both the farmer and stock holder's concerns has been accommodated in this contract farming scheme.

The syariah scheme has just developed since 2007, even just in non-agriculture sector. The syariah-based on contract farming doesn't develop maximally in both agriculture and livestock sectors since the stock holder doesn't want to take a risk. The development of this scheme in the sugar cane business just because the stock holder could manages and dominates the market, so that decrease the risk. This factor caused syariah-based on contract farming in sugar cane business sector could develops.

The important thing that needs to be studied further is why does this idea came up from an ordinary society, especially the local figure (kijaji) as the actor while both the state and the businessmen as the stock holder concerned to developing syariah-based on contract farming concept as the social business model in agriculture growth. This should considered in the next research.

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